

**CALIFORNIA PUBLIC EMPLOYEES' RETIREMENT SYSTEM  
STATEMENT OF INVESTMENT POLICY**

**FOR  
MANAGER MONITORING - EXTERNALLY MANAGED**

**May 14, 2001**

*This Policy is effective immediately upon adoption and supersedes all previous policies pertaining to external investment manager and currency overlay manager monitoring.*

**I. PURPOSE**

This document sets forth the objectives, responsibilities and criteria ("the Policy") for Manager Monitoring – Externally Managed Program ("the Program").

**II. INTRODUCTION**

Under the direction of the Board and senior management of the California Public Employees' Retirement System ("the System"), the System's Investment Staff ("the Staff") shall manage the implementation of investment strategies of external investment manager portfolios. In order to ensure the investments achieve strategic return and risk objectives, it is necessary to monitor each portfolio for compliance with the criteria that are specific to its particular mandate as well as reflective of the strategic role the portfolio has been selected to fulfill within the investment program.

The Staff develops specific guidelines that outline the manager(s)' strategies, portfolio characteristics, authorized investments and markets, benchmarks and performance objectives. These guidelines become part of the contractual agreement with each firm. Managers are given discretion over the selection of individual securities in the portfolio, in accordance with their guidelines, but are expected to invest the System's assets in compliance with the specific guidelines included in their contracts. The Staff shall closely monitor investment managers in order to:

- A.** Evaluate whether managers have achieved their stated investment objectives;
- B.** Ensure that managers adhere to their specific investment process; and
- C.** Assess the impact of any significant investment firm changes, such as staff, client base, or ownership.

It should be noted that the System does not specifically approve individual transactions in the portfolios or impose restrictions on investing, except for those stated in the manager's contracts and guidelines, or restrictions imposed by law.

### III. RESPONSIBILITIES AND DELEGATIONS

- A.** The **System's Investment Committee** ("the Investment Committee") is responsible for approving and amending the Policy. The Investment Committee delegates the responsibility for administering the externally managed portion of the System to the Staff through the Delegations of Authority (Delegation Nos. 89-13 and 95-50).
- B.** The **System's Investment Staff** ("the Staff") duties include, but are not limited to, the following:
1. Developing and recommending the Policy to the Investment Committee.
  2. Developing and maintaining a procedures manual, subject to periodic reviews and updates, outlining Staff operational procedures to be used in implementing this Policy;
  3. Implementing and adhering to the Policy;
  4. Recommending action with respect to the manager(s) retained to implement the Program, in accordance with the Policy or with respect to changes in the manager's contractual guidelines, or regarding any other aspect the Staff considers pertinent.
  5. Reporting to the Investment Committee, as needed, about the performance of the Program. The Staff shall report concerns, problems, material changes, and all violations of Guidelines and Policies immediately, and in writing, to the Investment Committee. Reports made by the Staff to the Investment Committee shall include explanations of the violations and appropriate recommendations for corrective action.
- C.** **Manager(s)** ("manager(s)") are responsible for all aspects of portfolio management as set forth in their respective contracts with the System and shall fulfill the following duties:
1. Communicate with the Staff as needed regarding investment strategy and investment results. The Managers are expected to monitor, analyze, and evaluate performance relative to the agreed upon benchmark; and

2. Cooperate fully with the Staff, the System's custodian and the General Pension Consultant concerning requests for information.
- D.** The **General Pension Consultant** shall be responsible for independently monitoring and evaluating the managers and for reporting recommendations, if any, directly to the Investment Committee on a quarterly basis, in accordance with the terms of its contract.
- E.** **Special Project Consultants** may be hired to provide specific advice concerning various issues pertaining to the implementation of the Program. These issues include the following issues:
1. Investment research on topical issues;
  2. Investment policy;
  3. Manager research; and
  4. Performance measurement and analysis.

Consultants may also be used to monitor and report organizational changes at investment firms.

#### IV. MANAGER EVALUATION

- A.** The ongoing evaluation of investment managers includes both qualitative and quantitative reviews of the firms. Qualitative monitoring involves reviewing the following organizational aspects:
1. Ownership;
  2. Staffing;
  3. Growth;
  4. Client service;
  5. Investment approach;
  6. Business risk and
  7. Regulatory issues.
- B.** Quantitative monitoring requires analysis of the implementation of the investment approach:

1. Investment style,
2. Performance and
3. Portfolio risk.

Staff shall develop and maintain specific watchlist criteria detailing the qualitative and quantitative factors to evaluate managers.

As determined by Staff through its evaluation and monitoring of managers if significant events occur which will likely affect long-term overall performance, the manager shall be placed on Watchlist Status or considered for Dismissal.

**Watchlist Status** - Indicates a level of concern which shall be unique to each situation and quantified by Staff to the Investment Committee. This level of concern can range from minor to major deficiencies. A recommendation for Watchlist Status shall designate a period of time to assess the capabilities and quality of a Manager's operations and include more frequent contact with the firm to monitor the conditions that led to the Watchlist Status. Managers placed on Watchlist Status shall be requested to submit a Plan of Action to address the deficiencies and shall typically remain on Watchlist Status for performance-related issues or organizational changes for up to one year to ensure that outstanding issues are resolved. Managers who do not correct outstanding issues in a timely manner shall be considered for Dismissal.

**Dismissal** - Staff shall recommend Dismissal of a manager if adequate improvement in the areas outlined in the Plan of Action has not been made; however, Staff may recommend Dismissal for any reason upon thirty days' notice to the manager.

From time-to-time, Managers may not incur Watchlist Status (because performance slightly exceeds the benchmark), but may not have met their performance objective (expected excess return over the benchmark) as specified in their Investment Management Guidelines. In cases where the benchmark return is surpassed, but expected excess return has not been earned during a significant period of time (three years), Staff may recommend Watchlist Status.

### III. GLOSSARY OF TERMS

The following Glossary of Terms contains definitions also referenced in the CalPERS Master Glossary of Terms.

**Dismissal** - Termination of the investment management contract with CalPERS.

**Manager** – External investment managers and currency overlay managers.

**Watchlist Status** – Indicates a level of concern, the degree of which shall be unique to each situation and quantified by Staff to the Investment Committee.

**CALIFORNIA PUBLIC EMPLOYEES' RETIREMENT SYSTEM  
STATEMENT OF INVESTMENT POLICY**

**FOR**

**REAL ESTATE INVESTMENT MANAGER MONITORING PROGRAM –  
EXTERNALLY MANAGED**

**August 11, 1999**

*This Policy is effective immediately upon adoption and supersedes all previous external real estate investment manager monitoring policies.*

**I. PURPOSE**

This document sets forth the investment Policy ("the Policy") for the External Real Estate Investment Manager Monitoring Program ("the Program"). External investment managers ("Management Firms") are expected to invest the California Public Employees' Retirement System's ("the System") assets in accordance with the specific guidelines included in their contracts. When Management Firms are retained, they may be given discretion over the selection of individual assets in a portfolio, subject to an approved matrix of investment guidelines. Management Firms also may have an ownership interest and co-investment.

**II. MONITORING OBJECTIVES**

Under the direction of the Board and senior management, the Investment Staff shall create and manage the implementation of investment strategies and policies in the System's externally managed real estate investment portfolios.

The System may allocate assets to Management Firms for constructing an investment program that meets its overall performance objective. These assignments are made pursuant to a specific performance objective, risk profile, and implementation process for that portfolio designed to maximize the System's total return versus the risk incurred. Ensuring that each portfolio achieves its strategic risk and return objective(s) within the established parameters, portfolios must be monitored for compliance with the criteria specific to its particular mandate.

Outlined below are the monitoring objectives of the Program:

- A. Evaluate whether Management Firms have achieved their stated investment objectives;

- B. Ensure that Management Firms adhere to their specific investment process; and
- C. Assess the impact of any significant Management Firm changes, such as staff, client base, structure, or ownership.

### III. RESPONSIBILITIES AND DELEGATIONS

- A. The **System's Investment Committee** ("Investment Committee") is responsible for approving and amending the Policy and delegates the responsibility for administering the Program to the Staff through the Delegation of Authority (Delegation Nos. 89-13 and 95-50).
- B. The **System's Investment Staff's** ("the Staff") duties include, but are not limited to, the following:
  - 1. Developing specific guidelines, outlining the Management Firm's strategy, portfolio characteristics, authorized investments and markets, benchmarks and performance objectives. These guidelines are part of the contractual agreement with each firm;
  - 2. Developing and recommending the Policy to the Investment Committee;
  - 3. Developing and maintaining a procedures manual subject to periodic reviews and updates outlining Staff operational procedures to be used in implementing this Policy;
  - 4. Implementing and adhering to the Policy;
  - 5. Recommending action concerning the Management Firms retained for implementing the Program in accordance with the Policy. The Investment Staff shall also recommend changes in the firm's contractual guidelines or any other aspects Staff considers pertinent; and
  - 6. Reporting to the Investment Committee, periodically, about the performance of the Program, and monitoring Policy implementation and compliance. Staff shall report all violations of the Policy to the Investment Committee, along with explanations and appropriate recommendations for corrective action.

- C. The Management Firm is responsible for all aspects of portfolio management as set forth in the firm's contract with the System and shall have the following duties:
  - 1. Communicate with the Staff as needed regarding investment strategy and investment results. The Management Firm is expected to monitor, analyze and evaluate performance relative to the agreed-upon benchmark.
  - 2. Cooperate fully with the System's Staff, the Custodian, and consultant(s) on requests for information.
- D. On request by the System, the Real Estate Pension Consultant shall be responsible for independently monitoring and evaluating the Management Firms. The Real Estate Pension Consultant shall report recommendations, if any, directly to the Investment Committee on a quarterly basis, in accordance with the terms of its contract.

#### **IV. MANAGEMENT FIRM EVALUATION**

The ongoing evaluation of Management Firm includes a periodic, written evaluation based on qualitative and quantitative criteria.

##### **A. Qualitative Criteria**

Qualitative monitoring involves reviewing organization aspects: ownership, staffing, growth, client service, investment approach, business risk, and regulatory issues. Consideration will also be given to the financial strength of the investment management organization, the level of client service given the System, and changes within the managing organization such as the continuity of personnel assigned to the System's investments.

##### **B. Quantitative Criteria**

Quantitative monitoring requires analysis concerning the implementation of the investment approach: asset selection, performance, and portfolio risk.

##### **C. Contract Review Status**

When quantitative or qualitative factors evaluating Management Firms deteriorate, appearing likely to affect long-term overall performance, the Management Firm shall be placed on Contract



Review Status. The three levels of Contract Review Status are Watchlist, Probation, and Dismissal, and are outlined as follows:

1. **Watchlist** status indicates an increased level of concern, but does not indicate major deficiencies. A recommendation for Watchlist status shall designate a period to assess the capabilities and quality of a manager's operations. Management Firms shall typically remain on Watchlist for performance-related issues or organizational changes for up to one year in order to ensure that outstanding issues are resolved. Management Firms not correcting their outstanding issues in a timely manner shall advance to a more critical phase of Contract Review – Probation Status or Dismissal.
2. **Probation** status indicates a level of serious deficiency. It indicates a need for more frequent contact with the firm to monitor closely conditions leading to its placement on Probation.
3. **Dismissal** - Staff shall recommend dismissal of a manager if adequate improvement in the areas outlined in the Plan of Action has not been made. However, the Staff may recommend dismissal for any reason upon a thirty-day notice to the manager.

## V. GLOSSARY OF TERMS

The following Glossary of Terms contains definitions also referenced in the System's Master Glossary of Terms.

### **Management Firms** – External Investment Managers

**Watchlist Status** – Indicates a level of concern, the degree of which shall be unique to each situation and quantified by Staff to the Investment Committee.